UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

U.S. COMMODITY FUTURES TRADING COMMISSION,

Plaintiff,

v.

BRIAN HUNTER,

Defendant.

07 Civ. 6682 (RA)

ECF CASE

DECLARATION OF MICHAEL C. McLAUGHLIN
PURSUANT TO 28 U.S.C. § 1746

I, Michael C. McLaughlin, hereby declare as follows:

1. I have personal knowledge of the facts stated herein, and if called as a witness, I could competently testify to those facts.

2. I have been employed as a futures trading investigator at the Division of Enforcement of the Commodity Futures Trading Commission ("CFTC") for thirteen years. My office is at 140 Broadway, New York, NY 10005. My duties as an investigator include investigating commodity firms and individuals located throughout the United States, for the purpose of ensuring compliance with and enforcement of the Commodity Exchange Act. As part of my duties as an investigator, I have interviewed witnesses, prepared investigative reports of those interviews, analyzed trading data and banking data and prepared reports concerning certain aspects of my investigative findings to be used in court.

3. I submit this declaration in support of Plaintiff's Motion *in Limine* to Allow Examination of Defendant Hunter Concerning Prior Credibility Findings in the U.S. Federal Energy Regulatory Commission Proceeding.

4. Attached hereto as Exhibit 1 is a series of excerpts from the Initial Decision issued by Presiding Administrative Law Judge Carmen A. Cintron on January 22, 2010 in the proceeding held by U.S. Federal Energy Regulatory Commission (the "FERC") in the *Matter of Brian Hunter*, Docket No. IN07-26-004 (the "FERC Initial Decision"). I downloaded the excerpts provided as Exhibit 1 from the FERC website at http://www.ferc.gov/enforcement/market-manipulation/hunter.pdf.

5. According to the transcript of the FERC proceeding, Hunter testified for four days, from August 18, 2009 through August 21, 2009.

6. Attached hereto as Exhibit 2 are true and correct copies of two pages excerpted from the transcript of the FERC proceeding.

I declare, under penalty of perjury, that the forgoing is true and accurate.

Michael C. McLaughlin

Executed on this 19th day of September 2013, in New York, NY

# Exhibit 1

UNITED STATES OF AMERICA 130 FERC ¶ 63,004
FEDERAL ENERGY REGULATORY COMMISSION

Brian Hunter Docket No. IN07-26-004

INITIAL DECISION

(Issued January 22, 2010)

*APPEARANCES*

*Michael Kim, Esq.*; *Matthew Menchel, Esq.*; *Andrew Lourie, Esq.*; *Daniel Rashbaum, Esq.*; *Leanne Bortner, Esq.*; and *Zaharah Markoe, Esq.*; on behalf of Brian Hunter.

*Todd Mullins, Esq.*; *Kenneth Behle, Esq.*; *Justin Shellaway, Esq.*; *Aaron Fate, Esq., Erik Baptist, Esq.*; *Laura Chipkin, Esq.*; *Jamie Jordan, Esq.*; *Lee Ann Watson, Esq.*; and *Blair Hopkin, Esq.*; on behalf of the Federal Energy Regulatory Commission Enforcement Staff.

**CARMEN A. CINTRON**, Presiding Administrative Law Judge

ALX's floor trader, appeared to have large quantities and was hitting bids consistently.[81] *Id.* at 1103-05, 1110-11.

160. Several anomalies make Hunter's explanation of his trading during the March 2006 natural gas contract settlement period (to profit from repeated strong March 2006 buying) problematic. First, Hunter sent a text on settlement day stating: "just need H (March 2006) to get smashed on settle." Ex. S-45. This would not likely hurt the 4,800 March 2006 futures Hunter acquired, since the spreads would largely insulate him from an absolute price decrease (see discussion *supra* P 159). However, Hunter also held a substantial short March 2006 swap position – 9,657 short March 2006 ICE swaps and 4,348 short March 2006 Clearport swaps - that would clearly benefit from a price decrease. Ex. S-1 at 97. Hunter does not offer an explanation of the NYMEX-equivalent swaps. Yet clearly his calculus would have included those swap positions, since his March 2006 strategy clearly impacts them. That he would be silent on something that is so significant seems odd, especially since the Order to Show Cause focused on these elements. Indeed, if Hunter felt there would be strong buying pressure during the settlement period, it is curious that he continued to hold such a large net short position into the settlement period.

161. Second, Hunter's attempt to beat the close by selling ratably seems unlikely to succeed, especially since the instruction to sell ratably precludes information gathering or feedback. That is, selling ratably yields roughly an unweighted-average of the prices observed over the close, and there is no statistical reason to expect this to consistently exceed the weighted-average price (the VWAP). Third, the bets that he claimed he took to benefit from strong repeat March 2006 buying seem poorly designed to profit from such a recurrence. The first bet- approximately 3,000 EFSs, the short March 2006 swaps/long March 2006 futures- is largely insulated from absolute price movements of the March 2006 natural gas contract. The second bet – 1,800 March 2006 (long) - April 2006 (short) spreads – is a bet that the price of the March 2006 natural gas contract will increase relative to that of the April 2006 natural gas contract. Only the smaller second bet seems consistent with his expectation that the event on the 23rd would repeat.

162. However, both bets are also insulated from falling March 2006 prices, and so not inconsistent with Enforcement Staff's averments. The value of the EFSs depends on how March 2006 futures sales performs relative to March 2006 swaps (both move together until close to the settlement period and, as discussed, the

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[81] Bolling was a local, trading on his own account. He described himself as a market maker, "if there are buyers looking for sellers, you sell. If there are sellers looking for buyers, you buy." Tr. at 1050.

weighted average sales price of the March 2006 futures is unlikely to exceed the VWAP, though an order sold ratably throughout the settlement period should come close to the VWAP). The value of the March 2006-April 2006 spread position is protected (albeit not perfectly) because, if the price of the March 2006 contract falls (and what he owns decreases in value), the April 2006 price is also likely to fall (thus increasing the value of his short April position). *See, e.g.*, Dr. King's Figure II (Ex. S-11 at 27), demonstrating how highly correlated these prices are.

163. The bets that he claimed he took to benefit from a strong repeat March 2006 buying thus seem poorly designed to profit from such a recurrence. Hunter continued to hold a large short swap position throughout the settlement period that would be harmed by price increases due to strong buying pressure while the EFSs and March 2006-April 2006 spread positions prevent him from benefitting substantially from price increases (just as they protect Hunter from absolute price decreases). Hence, the argument that he was going to benefit from repeated strong March 2006 buying is not credible.

164. Fourth, the distinction between paper and realized profits sheds light on Hunter's explanation. He may argue that driving down the price of the March 2006 natural gas contracts would hurt his short summer-long winter spread. But, as he often said, the whole curve tends to move together, and so if March 2006 natural gas contract fell, his summer gains would offset his winter losses. The offsetting gains and losses, however, are not symmetric. The gain on driving down the March 2006 natural gas contract is realized (since the swaps expire that day), whereas the losses on the long winter positions would be on paper. After the manipulation ends, the market would recover, and the paper losses would turn into paper gains.[82] Hence, it appears that Amaranth gained after the manipulation.

165. Hunter's explanation for the February expiry, that he wanted to beat the close, contradicts his defense that he only focused on his overall book and was never concerned with one-day price movements and trading in the front month contract. Tr. at 595-97. Hunter claims he does not recall a lot of the events that

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[82] This does not mean that the market goes up by the same amount as the manipulation pushed the market down – rather that the change in the market price the following business days would be whatever the market would have done absent the manipulation plus the amount of the manipulation. For example, if manipulation caused the market to close 5 cents lower on February 24, 2006, and the market would have closed 2 cents lower the following business day, then the market would close 3 cents higher that day- the 2 cents drop plus the 5 cent recovery from manipulation. *See*, note 54, *supra*.

are at-issue in this case and his only recollection comes from reviewing documents. *Id.* at 897-900. This testimony is not credible. Hunter exhibited significant selective memory in this case, which is inconsistent with his intelligence, experience and knowledge. Hunter could not satisfactorily explain why a two-minute settlement period for options would be replicated the next day for a thirty-minute close for futures. *Id.* at 456-59. Further, Hunter could not explain why the behavior of participants the previous day (trading to "squeeze the spread") would be replicated the next day during the settlement period. *Id.* at 457-59. Hunter's suggestion that market participants on February 23 were left holding futures is not conclusive since there is no evidence indicating that these market participants would have to wait until the settlement period to flatten out of their futures positions, rather than doing so earlier in the day. The most salient point is that Amaranth traded similarly during the next settlement period (March 2006 for the April contract) but there is no evidence to indicate that there was a similar rally on the penultimate day to justify another experiment.

166. Moreover, contemporaneous instant messages show his real mindset and thus are deemed admissions against interest. Hunter expected the market to go down from selling pressure. An instant message dated February 24 on or about 11:00 a.m. indicates he expected "H [March] will go off soft." Ex. S-43; Tr. at 465-66. He saw "futures sellers everywhere." Ex. S-43; Tr. at 465-66. In another instant message on February 24 on or about 1:30 p.m., Hunter conveys the thought that John Arnold (of Centaurus) and Sempra will be sellers. too. Ex. S-47. Additionally, in another instant message the same day on or about 11 a.m., Donohue asked Hunter if Centaurus was positioning for a "punch down" or "protecting up" and Hunter replied "punch down." Hunter in the same message states "they want it down Friday." Ex. S-54; Tr. at 463-65. It is curious that, given Hunter thought the behavior of February 23 would repeat on February 24, he did not try to reduce or eliminate his short March swap position sooner rather than wait until they expired.

167. The record demonstrates other contradictions in Hunter's conduct and his explanations. Consequently, the only conclusion to be reached is that his explanations are *ex post facto* and solely intended to obfuscate the truth. For instance, Hunter claims that 3,000 futures would not have an impact on the market at the close because this is not a lot of volume. *Id.* at 746-47. However, his experiment required that he "have a large enough number of lots to be meaningful to the settlement average" (*Id.* at 724) and that the pit understand he had a lot of volume to sell, in order to have buyers come to him. *Id.* at 724, 730-31. He communicated to a trader of a competing company that he had a lot of volume to sell. *Id.* at 708-10. He was signaling others he had a lot of volume to sell.

168. Hunter claims he could not have known on February 23 that a decline in March settlement prices would benefit his book because he could not know what would happen to other prices out the curve, for instance, the winter contracts. *Id.* at 691, 694. However, the evidence demonstrates that Hunter could run stress scenarios and make predictions of likely outcomes. Ex. RES-4-1 at 17-18. He could make an informed judgment as to what would happen to the summer prices.

169. Moreover, one could argue that if Hunter really expected buying pressure on February 24, as happened on February 23, the way to beat the close would have been to wait to see if the buying occurred and sell when prices were higher and not sell ratably during the close. Hunter alleges that his strategy depended on his offers getting lifted (buyers in the pit would come to him and higher offers would be lifted as opposed to his broker having to hit bids in order to sell). However, nothing in this record supports this. Hunter does not recall telling his broker to have offers get lifted. Tr. at 469-70. There is also no evidence that he instructed Donohoe to have offers lifted instead of hitting bids. *Id.* at 994. This is not what happened. As stated above, what happened is that Amaranth's brokers were hitting bids repeatedly and consistently and selling below the average prices of all others in the market. *Id.* at 1103. There is no record evidence of Hunter checking during the close to see if Amaranth was having offers lifted and there is no evidence that after the close Hunter complained to his traders (ALX) or chastised them for not complying with his instructions. *Id.* at 469-70. Finally, it is not credible that an experiment was conducted and yet Hunter could not recall on the witness stand whether it was a success or not. *Id.* at 470. Hunter's execution trader did not remember anything about an experiment either. *Id.* at 994. Hunter and Donohoe are not credible.[83] The record evidence does show that Hunter intended to conduct an experiment to lower the price of the March futures, to benefit his short positions on other exchanges.[84] His assertions to the contrary are not credible.

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[83] Donohoe was Hunter's friend and his execution trader at Amaranth. Tr. at 330.

[84] Note that this pattern is consistent with findings in the Senate Report for the September prompt futures. For the September prompt-month, Amaranth stopped trading in NYMEX around 1:15 p.m. and shortly thereafter concluded its trading on ICE. Staff Report, *Excessive Speculation in the Natural Gas Market* (2007) *supra* note 37, at 107. Shortly after Amaranth exited the market the price of the September contracts began to rise and the September/October spread began to narrow. *Id.* Amaranth's selling helped keep the price of the September contract down and the spread wide. *Id.*

**March Settlement (April Futures)**

170. Record evidence conclusively establishes Hunter was out of the country during this settlement period. Hunter was in the Maldives; his execution trader Donohoe was in Greenwich. Tr. at 334, 471. It is also undisputed that trading in this period exhibited similar patterns to the previous month. Through Hunter's book, Amaranth again traded a large quantity of prompt-month futures in the thirty-minute settlement period while holding large short prompt-month NYMEX-equivalent positions on other exchanges.[85] Hunter and Donohoe claim that there was nothing salient about this month which would help them remember what happened. Tr. at 471, 968. However, this was the second time Amaranth had traded such large positions in the final settlement period. Therefore, their testimony about their lack of recollection is not credible. There were some communications between Hunter and Donohoe, however Hunter argues this was not related to trading but to Harry Arora's (another Amaranth head energy trader) departure. *Id.* at 473, 475-77; Exs. S-33, S-51. It is noted that there was no penultimate day rally as happened in the previous settlement in February.

171. The record establishes Hunter was responsible for Amaranth's natural gas book. Tr. at 955. Hunter understood his approximate overall positions. *Id.* at 471-78. Donohoe, Hunter's execution trader, did not have authority to determine Amaranth's trading strategy. *Id.* at 957. Donohoe executed orders on behalf of Hunter. *Id.* at 911. There is no record evidence that Donohoe traded against Hunter's wishes in this month or was reprimanded or cautioned for trading outside of his authority or against Hunter's wishes. Based on the evidence in this record and considering what transpired the previous and the following month (a pattern of conduct) it is found that Hunter again lowered the price of the prompt-month future to benefit his short position in NYMEX-equivalents in the other exchanges in contravention of the Anti-Manipulation Rule.

172. The evidence demonstrates that Amaranth's behavior in the March settlement period was quite similar to that of the previous month – selling futures ratably during the close at prices generally below contemporaneous trades while holding a large short swap position that would benefit from falling prices.[86] Such

[85] Hunter's NYMEX-equivalent swaps were many times the size of his futures positions. Ex. S-1 at 111.

[86] The 2006 short summer-long winter spread got much longer and the overall portfolio got somewhat longer. Hunter testified that he never wants his book to get out of balance, but he allowed this to take place while he was on vacation. This is a significant deviation from the goal of maintaining a balanced spread, and so a significant anomaly that was not explained by Hunter.

a strategy also does not require Hunter's presence, as it may be implemented with a simple instruction. Accordingly, it is found that Hunter is not credible. He has developed a story to defend his actions in this matter which is inconsistent with the record evidence. Further, it is additionally found that he intended to lower the price of the April futures to benefit his short NYMEX-equivalent positions in the other exchanges.

**April Settlement (May Futures)**

173. The trading for the April settlement (May Futures) was different from the previous two periods, as Amaranth's sale of prompt-month futures was concentrated in the last eight minutes of the settlement period rather than the entire thirty minutes and the transactions were executed through three brokers: ALX, Gotham, and TFS, rather than solely through ALX. The record shows there were specific instructions to sell in the "last eight minutes." Tr. at 971-74; Exs. S-1 at 117, S-246, S-162 at NX_USSEN_01548 and NX_USSEN_01584. In an instant message on April 26, 2006, at 2:06:58 PM EDT, Brian Hunter stated "we are waiting to sell." Ex. S-17. Donohoe did not remember why he gave the instruction to execute the trades in the last eight minutes. Tr. at 968-69, 978-79. This testimony is not credible. This witness exhibited significant lack of candor on the witness stand, which can be attributed to the fact that, as of the time of the hearing, he was still very good friends with Hunter, and they talk nearly everyday.[87] *Id.* at 964:13-18.

174. It is found that this trading influenced the price of the May contract (prompt-month) and the price of the June 2006 contract (prompt-next month).[88] Amaranth had significant short May and June position which benefited from the lower prices.

175. Hunter maintains that the April trading was done to reduce the book. According to Hunter's testimony, this allegedly would be done by selling long winter contracts and buying or otherwise liquidating short summer positions. Tr.

[87] Hunter and Donohoe are defendants in a pending civil lawsuit. *In re Amaranth Natural Gas Commodities Litigation,* No. 07-6377, 612 F. Supp. 2d 376 (S.D.N.Y. Apr. 27, 2009). Hunter is also a defendant in *CFTC v. Amaranth Advisors, L.L.C.*, No. 07 Civ. 6682 (S.D.N.Y.). Amaranth Advisors L.L.C. and Amaranth Advisors (Calgary) U.L.C. settled with the CFTC. *CFTC v. Amaranth Advisors, L.L.C.*, U.S. Dist. 101406 (S.D.N.Y. Aug. 12, 2009).

[88] This contract settles during the last two minutes of trading. The prices of the adjacent natural gas contracts or those contracts with close expiration dates are highly correlated. Ex. S-1 at 118-19.

Q Number 3, what you actually did, you sold futures in the close, right?
A That day, I sold futures in the close.
Q That was option 3 that you testified earlier when your lawyer was asking—
A What I am going to say is that day, I sold futures in the close.
Q Right.
A That's it. That day, I sold futures in the close. I do not agree that 3 and selling futures in the close are necessarily the same thing. I just said I sold futures in the close. That is all I am going to say.
Q What's the wrong with admitting selling futures in the close is with number 3?
A I'm just saying I sold futures in the close. That's a true statement.

(Tr. at 895:5-20.)

178. Moreover, Hunter could have expired May swaps in direct proportion to the sold winter positions. *Id.* at 485-86. In the letter to NYMEX quoted above, Amaranth admitted that this approach would have been easy. Ex. S-170; Tr. at 486. Hunter admitted that this would not have required selling futures in the close. Tr. at 486. Hunter built up a number of futures to roll or sell during this settlement period to offset the selling of winter longs, Hunter could have done the same thing with May swaps. He could have rolled swaps into June. The record in this case is devoid of an explanation of why Hunter's executed trades were superior to this alternative.

179. Amaranth could also have reduced its position by trading a spread. *Id.* at 485. According to Hunter, this had advantages and disadvantages. *Id.* at 787-89. One disadvantage Hunter mentioned was the fact that he did not want to signal the market about large Amaranth trades. *Id.* at 788. However, Hunter executed a large May/June trade (10,000 lots) with Centaurus on April 26th. This trade by its very nature had to send signals to the market. Thus, Hunter's testimony in this regard is not credible.

180. There were other alternatives. Hunter could have bought summers and sold winters in separate transactions. *Id.* at 790-91. Hunter asserted that this was risky, because during the time that one "leg" has been lifted the other still needs to be lifted exposing the firm to price movements. *Id.* However, the evidence in this case establishes that Hunter subjected Amaranth to this risk by expiring off a

significant summer position (the May swaps) even though he had not sold a corresponding winter position. Ex. S-233 at Amarnath_Reg07359.

181. Indeed, Hunter's strategy seems needlessly complex compared with a direct and simple strategy of selling whatever winter length he could and, very shortly thereafter each sale, buying the same quantity of summer length (for example, June, July, August, and September) to maintain spread balance. Tr. at 483-85. That is, Hunter could have adjusted his summer positions in the out months (beyond what he already had in May to expire). Moreover, this carried little delivery risk since adjustment focuses on the out months. Tr. at 488. Also, if Hunter was worried about signaling information to the market with his trades, he could have used multiple brokers to execute his trades as he did with the May futures he sold on settlement day. Furthermore, this would not lock Hunter into having to unwind complex and costly-to-acquire positions if he failed to sell many long winter lots. The method Hunter chose seems more complicated and costly than he needed for what he wanted to do.

182. The following is Hunter's testimony:

Q Another way to do this is just not have a May position at all, have the positions in June that you would need to adjust, depending on how many of those winter contracts you could sell; right?
A You mean if I sold winter, then I could go try and buy a corresponding amount of June?
Q Adjust the June positions and not have to worry about the May position that's going to expire.
A By adjust, the only way to adjust it is to buy June; right?
Q Sure, if you say so. That's another way to do it; right?
A I think it's the only way to do it.
Q Okay.
A But yeah, that's an option.
Q And that wouldn't require you to sell futures in the settlement period for the May contract, would it?
A If you're buying June, it wouldn't require you to do so, no, but you could. You could do it that way.

(Tr. at 486-87.)

183. Hunter claims that on April 26 they spent the day trying to sell winter positions, which would determine the number of futures that would have to be sold (and the number of swaps that would be expired) and that is why they waited until the last eight minutes to sell futures. However, this part of the story is not

credible. The record supports the opposite. There are contemporaneous instant messages on April 26 which show that Amaranth was unable to sell winter until at or about 2:00 p.m.[91] Exs. RES-20-47, 20-48, 20-49; Tr. at 1030-34. In these instant messages, Donohoe is discussing attempts to sell and sales of winter "five minutes before the end of the close and 15 minutes before the end of the close, and into the close."[92] RES-20-47, 20-48; Tr. at 1031-32. The evidence in this case establishes that Donohoe was trying to sell winter seven minutes before the settlement period expired, which was after Amaranth had placed its order to sell futures in the last eight minutes of the settlement period. The inference drawn from this evidence is that there was no relationship between selling winter in the close and selling futures within the last eight minutes of the close.

184. Hunter's explanation for the instruction to sell in the last eight minutes is not credible. Since May was the expiry month, why wait for the last eight minutes to start selling positions that needed to be closed? Further, if the positions needed to be closed, the traders knew this and, therefore, did not need to be reminded.

185. The record evidence also demonstrates that Hunter misrepresented his June position on the witness stand. He stated he was quite long June explaining an instant message with Glover in which he stated he was a touch worried about a lower close. A lower settlement price, Hunter testified, would hurt his long June position. As the evidence shows Hunter was short in May and in June. Tr. at 798.

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[91] The instant messages made Hunter testify (he claims no independent recollection) that after the settlement period started the price of the winter futures became more appealing. *Id.* at 496. However, he would have no idea in the morning that that would be the case, and so would have no reason to wait for such an appealing price. Furthermore, the instant messages do not indicate that price was at issue. There is no evidence of efforts to sell winter during the day or that the price of these contracts changed during the day. These contracts, which are somewhat out on the curve, trade every day in large volume. Tr. at 530. The trade data shows that there was a sale at 1:30 p.m. at $1.98. Exs. RES-20-45; S-1-5 at AMARNTH_REG057018_Trades_2006_Jan_May_WithID.xls. Contracts sold during the settlement period at mostly lower prices ($1.96 to $1.97, one sale was at $2.00), not at better prices, as Hunter testified. Exs. RES-20-47, 20-48, 20-39, 20-40; S1-5 at AMARANTH_REG057018_Trades_2006_Jan_May_WithID.xls.

[92] In another instant message, Hunter says that they were going to "sell Cal 7 and 8" and "H/J" spreads to protect their winter position. Ex. S-18; Tr. at 497-500. Donohoe testified that selling H/J and Cal 8 was a proxy for selling winter. Tr. at 1027-28. However, the transactions dealing with the H/J spread (H is March '07/winter and J is April '07/summer) reduce the book independently of the selling of May futures. Tr. at 819, 820:8-15.

He moved a part of his short position from June to May, but that still left him short in June. *Id.* Since Hunter was short both months, lower May and June prices would benefit these positions. Hunter also stated a lower May price would hurt him because he had a May/June spread based on a trade he entered into with Centaurus. In this trade he rolled a 10,000 lot (bought June at the May settlement price plus about 21 cents). Tr. at 492, 555-56. However, Hunter testified that any spread involving May would disappear at the close of settlement, at 2:30 p.m. *Id.* at 558, 810. Moreover, if May fell as much as June, the moves theoretically would have no effect on the May/June roll. If May had fallen more than June, he probably would have done better. *See*, *id.* at 559. Indeed, if prices had gone down throughout the settlement period, Hunter would have done even better. During the settlement period prices went up then down, and this was profitable for Hunter (although not as profitable relative to not rolling May into June).

186. Another related aspect of Hunter's explanation that is troublesome is that he fails to explain, given the importance he attaches to balancing the book, why the book exhibited so much variation in the extent to which it was imbalanced (the amount by which it was net long or short). Hunter's attorney illustrated this point, saying:

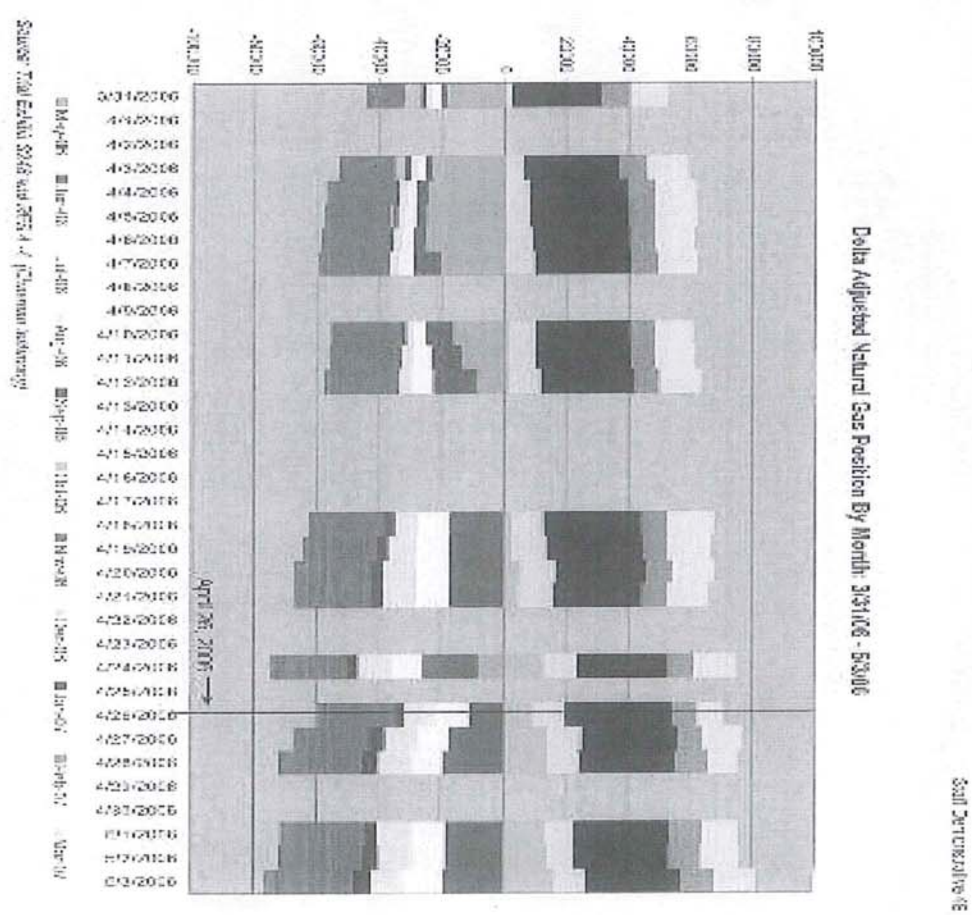
> "He never wants his book to get out of balance. Here was his thing: If he sold a lot of winter length, more winter length than he had summer shorts, his book would also be out of balance. That's what he never wants to happen." (*Id.* at 246.)

In Hunter's own words: "So the idea, when you try and reduce – because it actually can get quite complex—is that you want to reduce in such a way that you kind of keep your book in balance." *Id.* at 775:18-23-782. Hunter states that an imbalanced book is undesirable when discussing options for the April settlement day. *Id.* at 812. These statements are hard to reconcile with the increase in the summer-winter spreads subsequent to the settlement periods at-issue in this case. Regarding net length, Hunter testified that his book was not perfectly balanced and that this would be sort of "somewhat a hedge against what we perceived spread movements might be." *Id.* at 320. Again, observing variation in the balance of the book subsequent to the expiration without explanation compels the conclusion that his explanation for his trading for this settlement period is not credible.

187. Enforcement Staff Demonstrative Exhibits 49 through 51 give an indication as to what happened to Hunter's book. The book becomes increasingly unbalanced over this time and tends to get increasingly long, though there is some volatility. Hunter failed to explain why the book continued to grow in subsequent months. Given the importance he placed on decreasing his book and that

decreasing the book is the foundation for his trading strategy for the last expiry, observing the book increase subsequent to the expiration without explanation cannot be reconciled with his story. This is another aspect of Hunter's explanation that is not credible.

188. Furthermore, considering the summer and winter elements separately, the book seems to be growing rather consistently. This seems inconsistent with Hunter's explanation that he was pressured to trim the book. Hence, Hunter's repeated claims that he never wants his book to get out of balance as he decreases his short summer-long winter spread position is inconsistent with how this spread evolved. Given the importance that Hunter attaches to maintaining a balanced spread, such an apparent inconsistency requires an explanation which is not found in this record. The inference to be drawn from this lack of explanation is that Hunter is not credible. This undermines Hunter's explanation for his trading of the May 2006 natural gas contract. Hunter's explanation is not credible, as there is little evidence of trimming here.



189. Additionally, in all of Hunter's explanations there is studiously an attempt to obfuscate the issue of the positions on the other exchanges. Hunter apparently did not want to mention these positions. There is no explicit explanation of how these positions fit into the strategy of unwinding Hunter's book. Given that the manipulation allegation keys in on the ICE positions, it is inexplicable that Hunter's explanation does not directly address his ICE positions. The ICE positions are, after all, in Hunter's Energy2 book and are clearly part of his summer-winter spread strategy (as they are short summer positions).

190. Further, in general, we have three months with heavy prompt-month selling (relative to what Amaranth typically sold). Ex. S-1 at 58. The pattern across the three months was quite similar, though the selling in the May 2006 contract was concentrated near the end of the settlement period rather than throughout the settlement period as for the March 2006 and April 2006 contracts. Hunter offers three explanations: the crushed spread for the February expiry, his vacation for the March expiry, and trimming the book for the April expiry. It seems curious that three very different explanations gave rise to largely the same trading behavior. For all of the complexity in Hunter's book reduction strategy, it is not inconsistent with Enforcement Staff's manipulation accusation. Hunter's short May and June positions benefited from falling May and June prices.

191. Based on the above, it is concluded that Hunter's arguments are not credible. The preponderance of the evidence demonstrates that Hunter intended to and did manipulate the prices in the three at-issue months. Accordingly, it is found that Hunter exhibited the requisite scienter and violated the first two prongs of Section 1c.1. The following is the last prong of Section 1c.1.

### 3) In Connection with the Purchase of Jurisdictional Natural Gas

#### Party Contentions

*Enforcement Staff*

192. Enforcement Staff explains that the question at issue in this proceeding is whether Hunter's trading was "in connection with the purchase or sale of natural gas . . . subject to the jurisdiction of the Commission." Enforcement Staff RB at 37, citing 18 C.F.R. § 1c.1. Hunter erroneously tried to heighten the standard by claiming that Enforcement Staff must show a "direct and measurable impact" and that Hunter's activity created an artificial price in the physical natural gas market. Enforcement Staff RB at 37.

193. According to Enforcement Staff, there are three factors to establish that the NYMEX futures settlement price is connected to physical markets. Enforcement Staff IB at 64, RB at 37. First, NYMEX natural gas futures contracts can become

to take the gas delivery obligation from Amaranth. Ex. S-1-5 at Amarnath_Reg057016_trades_2005_withid.xls.

210. Hunter was aware that NYMEX prices form the basis of physical transactions as part of the price formula. Tr. at 451-53. In addition, Hunter knew that "physical basis" transactions involve the delivery of physical gas in the form of a basis transaction and involve the final NYMEX natural gas futures contract as one leg of the transaction. *Id.* at 453-55; Ex. S-1 at 41-42. Moreover, Hunter was aware of industry publications (IFERC and NGI) which use NYMEX as a portion of the basis transactions. Tr. at 453-54. Accordingly, it is found that Hunter acted recklessly with regard to the effect his trades would have on jurisdictional transactions.[102] Enforcement Staff met its burden of proof in this regard. Hunter's arguments are contrary to record evidence and not given any weight.

**Penalty Factors**

211. The Commission stated that it reserved the imposition of civil penalties and would make a determination based on the record established in this proceeding. Hearing Order, *supra* note 7, at P 14.

212. The record evidence in this case demonstrates that Hunter violated the Commission's Anti-Manipulation Rule.[103] Hunter's violations were serious, willful and harmful. However, a consideration in Hunter's favor is that Hunter has no known previous violation of the Commission's Rules. Hunter intended to manipulate the price of natural gas futures contracts, which in turn affected the price of jurisdictional transactions. He knew physical and financial markets prices are interrelated. He recklessly disregarded the impact his manipulation would have on jurisdictional transactions. Hunter knew his conduct was improper and not in compliance with Amaranth compliance manuals and instructions. To wit, the Amaranth compliance manual prohibited traders from "engaging in 'marking the close' at or near the close of trading for the primary purpose of attempting to change the closing price to protect or alter the value of an existing position."[104]

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[102] Hunter argues that a future that goes to delivery is a fixed-price contract that is not affected by the NYMEX settlement price. This argument is flawed. The economic impact of the settlement price is either beneficial or detrimental to market participants who entered or exit the market during the period of manipulation by virtue of the true up of the settlement price *vis a vis* their margin accounts. In other words the settlement price will have a financial impact on the participant. Moreover, a physical transaction agreeing to pay a settlement price is hurt if that price is affected by manipulation.

[103] 18 C.F.R. § 1c.1.

[104] As President of Amaranth Advisors Calgary, U.L.C., Hunter was responsible

Ex. S-175. On the witness stand, Hunter testified that this type of conduct would be inappropriate. Tr. at 449-50. Additionally, Hunter has not been forthright with this tribunal. Hunter's explanations of his conduct are not credible and amount to after-the-fact defenses of his actions. Hunter held executive level positions at Amaranth. Accordingly, his conduct warrants close scrutiny due to his position.

213. There is no question that market manipulation harms the market. As Dr. Kaminski testified, manipulation that took place in this case diluted price discovery and affected hedging. Price discovery and hedging depend on pricing fundamentals and valid predictions about future values, and are impacted by manipulation since the prices then are not connected to fundamentals. Ex. S-1 at 53-55. The manipulation also impacted producers of natural gas who sold around this time frame using natural gas futures contract price as a price benchmark since they were paid less than the market price for their gas. Tr. at 913-20; Ex. S-10 at 12-13.

214. Enforcement Staff points out that Hunter was uncooperative during the investigation, failing to appear at a deposition and refusing to give sworn testimony. Finally, although Amaranth had a compliance manual in place, the violation still occurred and Amaranth did not self report the violation. Accordingly, it appears that Hunter does not deserve any credit for reduction of his penalty.

## IV. CONCLUSION

215. In this case Enforcement Staff has met its burden of proof.[105] The evidence shows that in February, March and April 2006, Hunter's trades were unique. Hunter's explanations of his conduct are not credible. Therefore, it is concluded that Hunter intended those trades solely for the benefit of Amaranth, he intended to lower the settlement price in those three months in order to benefit the book's positions in other markets. Consequently, it is found that Hunter's conduct was fraudulent, with the requisite scienter and with reckless disregard to jurisdictional transactions.[106] Accordingly, all three prongs of the Anti-Manipulation Rule have

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of ensuring employee knowledge of and compliance with this manual.

[105] On January 11, 2010, Enforcement Staff filed a declaration in compliance with the recently issued Policy Statement on Disclosure of Exculpatory Materials, 120 FERC ¶ 61,248 (December 17, 2009) (Brady Policy Statement).

[106] Amaranth dominated trading in the U. S. financial market in 2006. It frequently held 40 percent or more of the open interest in natural gas futures in a particular contract month. Its massive trading "moved prices and increased price

been met and it is concluded that Hunter violated Section 1c.1 of the Commission's Rules.

216. This order is subject to review by the Commission on exceptions or on its own motion, as provided by the Commission's Rules of Practice and Procedure.

Carmen A. Cintron
Presiding Administrative Law Judge

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volatility." Staff Report, *Excessive Speculation in the Natural Gas Market* (2007) *supra* note 37, at 114, 119. The conclusions in this decision supported by the record in this case are consistent with the findings in the Senate Report.

# Exhibit 2

BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: : Docket Number

BRIAN HUNTER : IN07-26-004

- - - - - - - - - - -x

Hearing Room 6

Federal Energy Regulatory

Commission

888 First Street, NE

Washington, DC

Tuesday, August 18, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:08 a.m.

BEFORE:

HONORABLE CARMEN CINTRON

ADMINISTRATIVE LAW JUDGE

PRESIDING JUDGE: This is for King, Kaminski, and Kaminski. What objections are you reserving?

MR. MENCHEL: We filed a motion to strike certain portions --

PRESIDING JUDGE: And I denied that this morning.

MR. MENCHEL: I understand.

PRESIDING JUDGE: The exhibits are admitted into evidence, and none of them have any identification as protected documents. All right.

(Exhibits S-1, S-10, and S-11 received.)

PRESIDING JUDGE: Proceed, Mr. Mullins.

MR. MULLINS: We call Mr. Hunter.

PRESIDING JUDGE: Please proceed to the stand, Mr. Hunter.

Whereupon,

BRIAN J. HUNTER

was called as a witness and, having first been duly sworn, was examined and testified as follows:

PRESIDING JUDGE: Go ahead, Mr. Mullins.

DIRECT EXAMINATION

BY MR. MULLINS:

Q Please state your name for the record.

A Brian Hunter.

Q Mr. Hunter, it's true, is it not, that on